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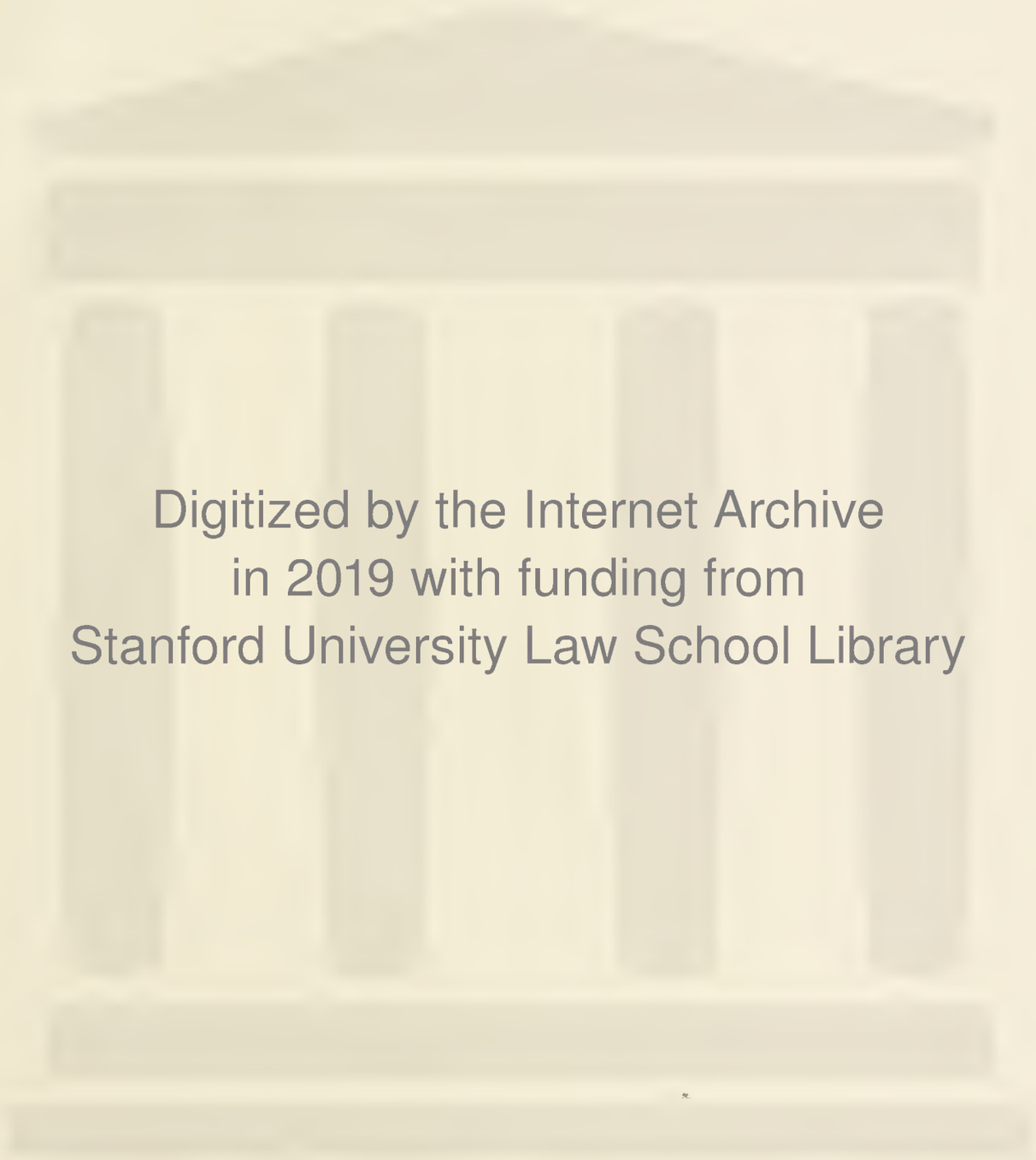

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THE TAXATION OF CIGARETTES, ALCOHOLIC BEVERAGES AND PARIMUTUEL WAGERING ACTIVITY IN CALIFORNIA

October 1981

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81-18

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INTRODUCTION

This paper discusses California's taxation of cigarettes, alcoholic beverages, and parimutuel wagering activity. It describes how these items are taxed in California, and compares the state's policy with those of other states. It also addresses the issue of whether California's current tax rates should be changed and if so how, and identifies the potential revenue effects of making various tax rate changes.

Taxes on cigarettes, alcoholic beverages, and parimutuel wagering yielded an estimated $456 million in 1980-81. This amounts to approximately 2.4 percent of estimated state General Fund revenues and transfers in that year.

These three taxes are often referred to as "sin" taxes. Of course, use of the term "sin" tax does not necessarily reflect a formal legal or moral judgment about the appropriateness or desirability of the activities being taxed. Rather, it acknowledges that this group of activities can lead to significant personal and social problems if carried to excess, and that some individuals are unable to resist carrying such activities to excess. Among the problems that may result if these activities are carried to excess are alcoholism, cigarette-induced lung cancer, and gambling addictions.

Clearly, such problems can and do impose significant personal and public costs on society, including the cost of health care, law enforcement, and payments for public assistance and unemployment benefits.

Thus, it is perhaps not surprising that all states levy special taxes on these activities that raise considerable amounts of revenue. Such taxes have been particularly appealing to many policymakers because the revenues generated from them can be used to partly offset any negative effects on society from these activities. Some policymakers may also find these taxes appealing because of their potential to reduce the rate at which these activities are carried on. At any rate, "sin" taxes have been, and will undoubtedly continue to be, an important revenue source for state governments.

There are several reasons why a review of California's "sin" tax policy is appropriate at this time.

- First, many members of the Legislature have shown an interest in this subject, and legislation to change the rates on certain "sin" taxes is now pending before the Legislature;
- Second, during periods of fiscal stringency, the determinants of state revenues should be examined with the same care as the programs that determine the level of state expenditures. Generally, revenues are not routinely reviewed on an annual basis, as are expenditures, so as to ensure that legislative intent and priorities are being observed; and
- Third, the rapid rate of inflation in recent years has had the effect of reducing the relative contributions which some individual taxes make toward financing state government. In particular, the tax revenues from those excise taxes which are levied on a cents-per-physical-unit basis have not kept pace with the prices government must pay for goods and services.

This is because the dollar revenues which these taxes produce only rise when the physical volumes of the taxed items increase, and such revenue increases are seldom enough to keep pace with inflation. Excise taxes in this category include both the cigarette tax (levied on a cents-per-pack basis) and the tax on alcoholic beverages (levied on a cents-per-gallon basis).

This paper provides a review of California's three major "sin" taxes--the cigarette tax, the alcoholic beverage tax, and the parimutuel wagering tax--in order to facilitate the Legislature's evaluation of whether the tax rates on these items should be changed. It discusses the rationale for changing the existing tax rates, the criteria which can be used in determining new tax rates, and the revenue implications of alternative tax rate policies.

This report was prepared in response to an increasing level of legislative interest in the subject of "sin" taxes. It was written by Jon David Vasche under the supervision of Peter Schaafsma.

SUMMARY OF MAJOR FINDINGS

1. A review of California's policy with respect to taxation of cigarettes, alcoholic beverages, and parimutuel wagering would seem to be appropriate for several reasons. Perhaps the most basic of these reasons is that, given the state's current fiscal situation, an examination of these taxes, conducted in a fashion similar to the review presently being focused on state expenditure programs, would ensure that the Legislature's current fiscal priorities are reflected here as well.

2. Relative to other states, it appears that California's level of taxation for cigarettes, alcoholic beverages, and parimutuel wagering is uniformly on the low side.

- California's cigarette tax rate of 10 cents per package is approximately 3 cents below the average for all other states (13 cents per package);
- California's distilled spirits tax rate of $2.00 per gallon is approximately 64 cents below the average for all other states ($2.64 per gallon);
- California's beer tax rate of 4 cents per gallon is about 13 cents below the average for all other states (17.2 cents per gallon);
- California's dry wine tax rate of 1 cent per gallon is 47.6 cents below the average for all other states (48.6 cents per gallon);
- California's effective tax rate of 6 cents per dollar wagered on parimutuel wagering is about one-half of 1 cent below the average for all other states (6.5 cents per dollar wagered).

3. California's taxes on cigarettes and alcohol have remained at their present levels for a significant period of time. The current cigarette tax rate of 10 cents per pack has been in place since 1967, while the current rates for distilled spirits, beer, and dry wine have been in effect since 1967, 1959, and 1937, respectively.

4. Because the taxation of cigarettes and alcohol has not been changed for some time, and because these taxes are imposed on a cents per unit sold basis, inflation has reduced both the relative contribution of these taxes to the General Fund and the "burden" of these taxes as a percentage of product price.

5. The General Fund revenue implications of increasing the rates of taxation for cigarettes, alcohol, and parimutuel wagering are not insignificant. For example, a 1 cent increase in each of the present rates could be expected to yield approximately $62 million on a full year basis, while setting California's rates at a level equivalent to the average of other state rates would generate some $272 million on a full year basis. Adjusting the rates simply to account for inflation in the prices of these items since 1970-71 would bring in approximately $255 million on a full year basis.

6. There are several criteria and objectives which should be considered in establishing the proper level of taxation for cigarettes, alcohol, and parimutuel wagering. Six major objectives or criteria have been identified in this report, however, they do not necessarily encompass all of the factors which should be considered by the Legislature in establishing its current tax policy. These criteria, or some combinations of them, offer a means by which the Legislature may establish a tax structure reflective of current legislative intent.

CHAPTER I

CURRENT TAX TREATMENT OF CIGARETTES, ALCOHOLIC BEVERAGES AND PARIMUTUEL WAGERING IN CALIFORNIA AND OTHER STATES

CIGARETTE TAXATION

Taxation in California

California currently levies a state excise tax of 10 cents on each pack of cigarettes made available for sale within the state. This tax, which is administered by the State Board of Equalization, is in addition to the federal cigarette excise tax of 8 cents per pack. Cigarette sales to members of the armed forces in exchanges and commissaries and to state homes for veterans are exempt from the tax.

Collections from the state's excise tax must be paid to the state by distributors (primarily wholesalers) no later than the 25th day of the month following the month in which the tax liabilities are actually incurred. Distributors are allowed a stamping or metering cost allowance of 0.85 percent of the tax, or 51 cents per case of 60 10-pack cartons. In the past, when the excise tax rate has been increased, the state has levied a special "floor tax" on cigarettes, making cigarettes held in inventories and on which the old excise tax has already been paid subject to an additional tax based on the difference between the new and old tax rates.

The California state cigarette tax was first imposed July 1, 1959, at a rate of 3 cents per pack. The rate was increased to 7 cents per pack on August 1, 1967, and then again to its current rate of 10 cents per pack on October 1, 1967. At present, there are no local taxes on cigarettes in California, as these were discontinued on October 1, 1967 when the state rate rose to 10 cents. Prior to that time, 39 California charter cities

levied cigarette taxes. California does not levy an excise tax on any tobacco products other than cigarettes.

The Department of Finance currently estimates that state cigarette tax revenues will reach approximately $286 million in 1981-82, of which about 70 percent ($202 million) represents General Fund revenues, and 30 percent ($84 million) represents special fund revenues which will be distributed to cities and counties using a formula based on population and taxable sales. The division of these revenues between the state and local government was established in 1967, when the state tax rate increased to 10 cents and cities were forced to discontinue their own cigarette taxes. In addition to these excise tax revenues, both the state and local governments collect additional sales tax revenues as a result of the cigarette excise taxes, because the sales tax rate is applied to the price of cigarettes including the excise tax. In 1981-82, these sales tax revenues will amount to about $13.6 million for the state and $3.6 million for local government, or a total of $17.2 million.

Taxation in Other States

Table 1 shows the state cigarette tax rates imposed by other states. It shows that all 50 states currently tax cigarettes, with tax rates per pack ranging from a high of 21 cents (in Connecticut, Florida and Massachusetts) to a low of 2 cents (in North Carolina). Forty-five states have increased their cigarette tax rates since California last increased its rate in 1967. California's 10 cent rate is 3 cents below the average state rate of about 13 cents.

Table 1

Interstate Comparisons of Cigarette Taxation in 1980[a]

State	State Cigarette Tax Rate Per Pack	Weighted Average Cigarette Retail Price Per Pack (before sales taxes)[b]	State Excise Tax Rate as a Percent of Average Retail Price Per Pack (before sales taxes)
Alabama[c]	16¢	68.8¢	23.3%
Alaska	8	63.5	12.6
Arizona	13	63.3	20.5
Arkansas	17 3/4	64.7	27.4
California	10	66.4	15.1
Colorado	10	58.1	17.2
Connecticut	21	80.1	26.2
Delaware	14	66.0	21.2
District of Columbia	13	69.0	18.8
Florida	21	72.8	28.8
Georgia	12	62.6	19.2
Hawaii	15	67.6	22.2
Idaho	9 1/10	59.2	15.4
Illinois[c]	12	63.1	19.0
Indiana	10 1/2	58.3	18.0
Iowa	13	61.4	21.2
Kansas	11	59.8	18.4
Kentucky	3	49.4	6.1
Louisiana	11	62.6	17.6
Maine	16	62.9	25.4
Maryland	13	62.8	20.7
Massachusetts	21	70.8	29.7
Michigan	11	61.8	17.8
Minnesota	18	65.8	27.4
Mississippi	11	63.0	17.5
Missouri[c]	9	59.9	15.0
Montana	12	60.4	19.9
Nebraska	13	60.9	21.3
Nevada	10	63.3	15.8
New Hampshire	12	58.4	20.5
New Jersey[c]	19	68.7	27.7
New Mexico	12	63.0	19.0
New York[c]	15	65.9	22.8
North Carolina	2	50.0	4.0
North Dakota	12	62.0	19.4
Ohio	15	61.4	24.4
Oklahoma	18	65.8	27.4
Oregon	9	56.9	15.8
Pennsylvania	18	64.8	27.8

Table 1 (Continued)

State	State Cigarette Tax Rate Per Pack	Weighted Average Cigarette Retail Price Per Pack (before sales taxes)[b]	State Excise Tax Rate as a Percent of Average Retail Price Per Pack (before sales taxes)
Rhode Island	18¢	64.5¢	27.9%
South Carolina	7	54.7	12.8
South Dakota	14	62.3	22.5
Tennessee[c]	13	63.7	20.4
Texas	18 1/2	66.9	27.7
Utah	10	62.7	15.9
Vermont	12	61.0	19.7
Virginia[c]	2 1/2	51.8	4.8
Washington	16	66.6	24.0
West Virginia	17	66.2	25.7
Wisconsin	16	64.9	24.7
Wyoming	8	55.9	14.3
Median for all States	13¢	63.0¢	20.6%

a. Source: The Tax Burden on Tobacco: Historical Compilation, Tobacco Tax Council, Inc., Volume 15. Data on tax rates and cigarette prices are as of November 1, 1980.
b. Includes state and federal excise taxes, but excludes cigarette taxes imposed by local governments.
c. One of seven states in which one or more units of local government impose cigarette taxes.

At present, about 370 individual cities and counties in seven states also levy cigarette taxes, ranging from 1 cent to 10 cents per pack. When these local taxes are included, the average overall tax rate for all states rises to about 13½ cents per pack.

In addition, 20 states levy taxes on tobacco products other than cigarettes. These noncigarette tobacco product revenues, however, account for less than 4 percent of total tobacco-related tax collections in these states.

Table 1 also shows the percentage of estimated average cigarette retail prices which state cigarette taxes represent in different states.

It indicates that in 1980, California's excise tax amounted to about 15 percent of the average retail price of cigarettes sold. This was well below the nationwide average of nearly 21 percent. In fact, the state excise tax as a percent of the average retail price per pack was lower in California than in all but seven states. California's 15 percent rate in 1980 was well below the 28 percent rate that existed in 1967 when the state's excise tax was last increased.

ALCOHOLIC BEVERAGE TAXATION

Taxation in California

California currently taxes alcoholic beverages on a cents-per-gallon basis, with different excise tax rates applying to different beverages. These taxes are imposed on all alcoholic beverages sold in California, including imports. The current tax rates are summarized in Table 2, and range from $2 to $4 per gallon for distilled spirits, 1 cent to 2 cents per gallon for still wines, 2 cents per gallon for sparkling hard cider, and 30

Table 2

Current Alcoholic Beverage Tax Rates in California

Type of Alcoholic Beverage	Tax Rate Per Gallon
a. Distilled Spirits:	
- 100 proof or less	$2.00
- Over 100 proof	4.00
b. Beer	0.04
c. Wine:	
- Still wine not over 14% alcohol	0.01
- Still wine over 14% alcohol	0.02
- Sparkling hard cider	0.02
- Sparkling wine, champagne	0.30

cents per gallon for champagne or sparkling wine. As with the cigarette tax, manufacturers and distributors of alcoholic beverages must file tax returns with and pay taxes to the State Board of Equalization on a monthly basis.

Alcoholic beverages generally have been subject to the same type of "floor taxes" as cigarettes, so that when tax rates have been increased, unsold inventories have been taxed at the new, rather than the old, excise tax rates.

Per gallon excise taxes on alcoholic beverages were first enacted in California in 1935. Since that time, tax rates have been changed infrequently. For example:

- The rate on sweet wine (2 cents) has never been changed since its inception,
- The rate on dry wine (1 cent) has not been changed since 1937, when it was reduced from 2 cents,
- The rate on sparkling wine has not changed since it was raised from 24 cents to 30 cents in 1955,
- The rate on beer has remained at 4 cents since 1959 when it was raised from 2 cents, and
- The rate on distilled spirits of 100 proof or less has only been revised twice--in 1955 (when it was raised from $0.80 to $1.50) and in 1967 (when it was raised to $2.00).

At present, there are no local taxes levied in California on alcoholic beverages.

The Department of Finance currently estimates that alcoholic beverage tax revenues will total about $147 million in 1981-82. Of this

amount, over 80 percent ($119 million) is derived from distilled spirits, with the remainder ($29 million) derived from beer (about $25 million) and wines (about $4 million). Under current law, all of these excise tax collections are deposited in the General Fund. As with cigarettes, both the state and local governments receive additional sales tax revenues from alcoholic beverage excise taxes, because these excise taxes are incorporated into the retail prices of alcoholic beverages on which the sales tax is levied. In 1981-82, these sales tax revenues will amount to about $7 million for the state and $1.8 million for local government, or a total of $8.8 million.

Taxation in Other States

Table 3 summarizes the basic alcoholic beverage taxes currently imposed by the 50 states. As the table illustrates, a simple comparison of alcoholic beverage tax rates between states is complicated by the variety of ways in which such taxes are levied. These methods include per gallon levies (as in California), ad valorem (or percentage) levies based on either retail or wholesale prices, and direct price markups where liquor stores are state-operated. In addition, many states differ in terms of whether they aim at taxing consumption, production, or both, and often tax alcoholic beverages produced in-state differently from those produced out-of-state. Nevertheless, it seems clear from Table 3 that California's rates are uniformly on the "low side" when compared to those in other states. For example:

- Of the 34 states which levy a cents-per-gallon excise tax on distilled spirits, 24 have rates which are above California's, while only six have rates which are below the state's.

Table 3

Interstate Comparisons of Alcoholic Beverage Tax Rates in 1980[a]

	Distilled Spirits (per gallon)	Wines (per gallon) 14% or Less Alcohol	Wines (per gallon) 14% - 21% Alcohol	Beer and Other Malt Beverages (per gallon)
Alabama	48% of Retail Price[b]	35% of Wholesale Price[b]	35% of Wholesale Price[b]	$ .53
Alaska	$4.00	$ .60	$ .60	.25
Arizona	2.50	.42	.42	.08
Arkansas	2.50[c]	.75	.75	.20[d]
California	2.00	.01	.02	.04
Colorado	2.16	.24	.36	.08[d]
Connecticut	2.50	.25	.25	.083
Delaware	2.25	.40	.40	.065
District of Columbia	1.50	.15	.33	.073
Florida	4.75	1.75	2.43	.40
Georgia	3.75	1.50	2.50	.32
Hawaii	20% of Wholesale Price	20% of Wholesale Price	20% of Wholesale Price	20% of Wholesale Price
Idaho	15% of Retail Price[b]	.45[b]	.45[b]	.15
Illinois	2.00	.23	.60	.07
Indiana	2.62	.45	.45	.095
Iowa	15% of Retail Price[b]	15% of Retail Price[b]	15% of Retail Price[b]	.14
Kansas	2.50[g]	.30	.75	.18[d]
Kentucky	1.92[h]	.50	.50	.081
Louisiana	2.50	.11	.21	.323
Maine	(b)	.30[b]	1.05[b]	.25
Maryland	1.50	.40	.40	.09
Massachusetts	4.05[e]	.55	.55	.106
Michigan	13% of Retail Price[b]	.50[b]	.50[b]	.203
Minnesota	4.39	.27	.79	.065
Mississippi	2.50[b,m]	.35[b]	.35[b]	.427
Missouri	2.00	.30	.30	.06
Montana	16% of Retail Price[b,i]	16% of Retail Price[b,i]	16% of Retail Price[b,i]	.129[d]
Nebraska	2.50	.55	1.10	.12
Nevada	1.90	.30	.50	.06
New Hampshire	(b)	(b)	(b)	(b)
New Jersey	2.80[f]	.30[f]	.30[f]	.033
New Mexico	1.50	.40	.40	.08
New York	3.25	.10	.10	.044
North Carolina	22.5% of Retail Price[b]	.833	.909	.534
North Dakota	2.50	.50	.60	.08
Ohio	1.60[b]	.60[b]	1.00[b]	.097
Oklahoma	4.00	.50	1.00	.323[d]
Oregon	(b)	.65[b]	.75[b]	.084
Pennsylvania	18% of Retail Price[b]	18% of Retail Price[b]	18% of Retail Price[b]	.08
Rhode Island	2.50	.40	.40	.065
South Carolina	2.72[j]	.90	.90	.768
South Dakota	3.05[k]	.30	.95	.268[d]
Tennessee	4.00[l]	1.10	1.10	.11
Texas	2.00	.17	.34	.161[d]
Utah	8% of Retail Price[b]	8% of Retail Price[b]	8% of Retail Price[b]	.10
Vermont	24% of Retail Price[b]	.50[b]	24% of Retail Price[b]	.25
Virginia	15% of Retail Price[b]	.35[b,f,n]	.70[b,f,n]	.256[d]
Washington	(b)	.75[b]	.75[b]	.032
West Virginia	(b)	(b)	(b)	.177[d]
Wisconsin	2.60	.195	.39	.065
Wyoming	.80[b]	.24[b]	.24[b]	.02

Footnotes to Table 3

a. Tax rates as of approximately December 1980. Sixteen states (Alabama, Idaho, Iowa, Maine, Michigan, Montana, New Hampshire, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming) have state-operated stores; North Carolina has county- and municipally-operated stores supervised by the state, while the remaining 34 states (including the District of Columbia) use some type of license system to control the distribution of alcoholic beverages. In addition to the rates shown in the table, states often levy special taxes on manufacturers, processors and dealers, and on components of beverages. In some states, brandy, vermouth, sparkling wines, or other specified beverages are taxed at different rates from general liquors and wines, and these rates are excluded in the table. Rates on quantities other than those shown may be at proportionate or higher rates and are also excluded, as are rates on distilled spirits in excess of 100 proof, on wines of more than 21 percent alcohol, and on malt beverages of more than 4 percent alcohol. Rates on beverages manufactured in the state are excluded when these rates differ from rates on imported beverages. Many states have such preferential tax rates for in-state production. For example, Minnesota levies an in lieu tax of 4 cents per liter on all wines produced by a Minnesota farm winery, compared to the basic rate of 27 cents per gallon. Likewise, Florida allows a 2 percent credit against taxes on wine levied on in-state manufactured or bottled wines, Maine allows a 10 cent reduction in the tax rate for in-state wines, and South Carolina allows reductions in the per gallon wine excise tax of 45 cents for between 14 percent and 21 percent alcohol content, and 85 cents for under 14 percent alcohol content.

b. Liquor stores are state-operated, and the state receives most or all of its revenue through price markups. Tax rates shown may be in addition to any state price markup, depending on the state.

c. There also is a wholesaler's tax of 20 cents per case.

d. For beer under 3.2 percent, except: in Oklahoma, South Dakota, and Kansas for beer over 3.2 percent; in Montana for beer under 7 percent, and in Texas for beer under 4 percent.

e. In addition, apart from certain specified exemptions, every corporation, association or organization which is licensed by any city or town to sell alcoholic beverages is taxed on the gross receipts from the sale of alcoholic beverages at the rate of 1/2 of 1 percent.

f. In Virginia, an additional tax is levied equal to 11.5 percent of the retail price. In New Jersey, an additional tax is levied of 6.5 percent of wholesale price, collected by wholesalers from retailers.

g. In addition, an enforcement tax of 4 percent of gross receipts from retail sales is levied.

h. In addition, there is a tax on wholesalers at the rate of 5 cents per case.

i. A license tax of 10 percent of retail selling price is also levied.

j. Includes a 9 percent surtax. In addition, there is a tax of $4.88 per case ($4.48 plus 9 percent surtax).

k. A tax of 2 percent of wholesale price from manufacturers or suppliers to wholesalers is also levied.

l. In addition, a tax of 15 cents per case is imposed upon sales at wholesale.

m. A tax of 3 percent of retail price is also levied.

n. An additional tax of 11.5 percent of retail price is imposed on all wine.

- California's tax on dry wine, which accounts for most wine sales, is the lowest of any state which currently imposes a cents-per-gallon excise tax.
- Only three states have a cents-per-gallon excise tax on beer which is below California's.

PARIMUTUEL WAGERING TAXATION

Taxation in California

California currently levies license fees on the dollar volume of parimutuel wagering (i.e., the parimutuel "handle") at individual California parimutuel horse racing meets.

Beginning in January 1981, a new license fee schedule became effective under the provisions of AB 3383 (Chapter 1043, Statutes of 1979), which reduced the overall rate of parimutuel taxation. This new schedule contains the following major license fee provisions:

(1) Thoroughbred horse racing meets which handle more than $250 million in wagering per year pay a license fee of 5.7 percent on "straight" wagers plus an additional 1.75 percent (or 7.45 percent total) on "exotic" wagers.[1] If, however, such a race meet is split into segments, the shorter portion of the meet is subject to the license fee for other thoroughbred meets as described in (2) below.

(2) All other thoroughbred meets pay a license fee of 4.8 percent on the first $2 million of daily handle and 6 percent on the excess over $2 million. However, the daily effective tax rate may not

1. Exotic wagers include exactas, quinellas, daily doubles, and Pic-Six.

exceed 5.1 percent, a constraint which applies when the handle reaches $2.45 million. These meets are also subject to the additional 1.75 percent license fee on exotic wagers.

(3) Quarter horse and harness meets pay a license fee of 2.5 percent on the first $550,000 of daily handle, 5.5 percent on the handle over $550,000 but under $750,000, and 4.7 percent on the handle over $750,000. However, the daily effective rate may not exceed 3.8 percent, a constraint which is reached at a handle of about $1.2 million. These meets are also subject to the additional 1.75 percent license fee on exotic wagers.[1]

(4) Fairs handling in excess of $650,000 in wagering per day pay a license fee of 3.65 percent, plus the additional 1.75 percent on exotic wagers. However, fairs overlapping in San Diego, Orange, or Los Angeles Counties pay 2.92 percent rather than 3.65 percent. For daily handles less than $650,000, the license fee is based on a sliding scale, which increases as the daily handle increases. A fair racing association which changes from day to night racing pays 2 percent on the first $1.5 million of daily

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1. Exceptions to the license fees for harness and quarter horse meets listed above include:
   (a) Split harness meets pay a license fee of 1.5 percent on the first $1 million of daily handle and 10.7 percent on the handle over $1 million, not to exceed a total of 3.04 percent per day (which is reached at a handle of about $1,200,000).
   (b) A quarter horse racing association racing in the northern zone pays a daily license fee of 1.5 percent on the first $550,000 of handle, 5.5 percent of the handle over $550,000 but less than $750,000, and 4.7 percent on the handle over $750,000. The daily fee cannot exceed 3.8 percent of daily handle (which is reached at a handle of about $2.3 million).
   (c) A quarter horse racing association in the southern zone that before 1981 raced days and now races nights reduces its license fee 2 percent for every 1 percent drop in handle from the previous year.

handle and 7.52 percent on the handle over $1.5 million, with the overall daily rate not to exceed 2.92 percent (a constraint reached at $1.8 million of handle).

In addition to these license fees, the state also collects revenues from several other sources, including breakage, unclaimed parimutuel tickets, and occupational license fees, fines and penalties. The most important of these additional revenue sources is breakage--the "odd cents" not paid to winning parimutuel ticket holders. Under current law, meets which handle less than $250 million in wagering retain all breakage on the first $125 million of the handle. Any additional breakage at these meets, along with all breakage on the amount of the handle over $50 million at other individual meets, is paid to the state.

The Department of Finance currently estimates that total state revenues from horse racing will be approximately $155 million in 1981-82. Of this amount:

- Approximately $141 million (or over 90 percent) will be derived from the license fees on parimutuel wagering described earlier, $9 million will come from breakage and $5 million will come from the remaining revenue sources.
- $128 million (or over 82 percent) will be placed in the General Fund, with the remainder distributed to five special funds: the Fair and Exposition Fund, the Wildlife Restoration Fund, the Sires Stakes Fund, the Racetrack Security Account in the Special Deposit Fund, and the Horsemen's Organization Welfare Account in the Special Deposit Fund.

Parimutuel wagering is not directly subject to any additional state taxes in California other than the normal tax treatment of gambling win-

nings under the personal income tax. A number of California localities, however, levy admission taxes on horse racing attendance.

Taxation in Other States

As the description of California's license fee rate structure indicates, parimutuel wagering taxation offers some of the most complex provisions in the tax statutes. Thus, comparing the state's parimutuel tax levies with those of the other 28 states which allow for parimutuel horse racing activity is even more difficult than it is for alcoholic beverages.

A summary of the basic provisions governing state parimutuel wagering taxation that were in effect during 1980 in these 28 states is included as Appendix I. That appendix also indicates the amount of money taken out of each dollar wagered in order to provide purses to horsemen and revenues to the racing associations and track operators who administer the racing meets. Similar provisions in effect in California during 1980 are also included for purposes of comparison; however, as noted above, AB 3383 changed some of these provisions, effective January 1, 1981.

Despite the difficulty of making interstate comparisons of parimutuel tax rates, a general comparison of California's overall parimutuel tax burden relative to those imposed by other states can be made based on the amount of parimutuel wagering taxes and breakage which are collected by states as a percent of total wagering. According to data published by the National Association of Racing Commissioners, in 1980 parimutuel wagering taxes and breakage amounted to about 7.35 percent of total wagering in California, compared to an average of 6.5 percent in other states.[1] Thus,

1. The computation for non-California states includes "off-track betting" (OTB) activity in Connecticut and New York.

California's average tax rate was somewhat above average in 1980. The Department of Finance, however, projects that because of the changes in California's state license fee schedule resulting from AB 3383, California's percentage will drop to about 6 in 1981-82, or about a 0.5 percentage point below the average rate for all other parimutuel horse racing states.

CHAPTER II

POSSIBLE OBJECTIVES AND CRITERIA TO BE CONSIDERED IN SETTING TAX RATES

Before discussing alternatives for establishing the level of any particular tax rate, it is necessary to consider exactly what the Legislature's objectives are in imposing the tax in the first place. These objectives will determine which specific criteria should be used in setting and revising the tax rate. Only if these objectives and tax-setting criteria are used will the actual tax structure necessarily reflect legislative intent. This is true for all taxes, including those on cigarettes, alcoholic beverages and parimutuel wagering.

Often, however, the Legislature's intent in enacting certain taxes and setting tax rates is not specified. This may reflect the fact that, for many tax programs, there is no consensus on either objectives or rate-setting criteria. Furthermore, the Legislature's original intent in enacting some taxes may no longer reflect the Legislature's intent in continuing these programs because of changing conditions. This may be true with respect to California's taxes on cigarettes and alcoholic beverages, which were enacted many years ago, and have not been changed for more than a decade.

We believe that there are six major general categories of possible tax objectives and rate-setting criteria which could be considered by the Legislature when establishing or reviewing tax rates. These categories, however, do not necessarily encompass all of the factors which should or

would realistically be considered by the Legislature in establishing tax policies. Nevertheless, they provide a good starting point for discussing what the levels of tax rates should be. Each of these six categories of possible tax objectives and rate-setting criteria is discussed below.

Category 1: Revenue Maximization

Under this approach, a tax rate would be selected to maximize the amount of revenues raised by taxing a particular commodity. This does not mean that tax rates would be increased indefinitely, however, because higher taxes tend to be reflected in higher product prices and, as prices rise, consumers eventually tend to restrict their purchases of the taxed items. Thus, at some point, the positive direct effect on revenues of higher tax rates will be outweighed by the negative impact of reduced purchases. It is at the point where the positive and negative effects offset one another that the tax rate should be set to maximize revenues. Of course, a proper application of this criteria also requires that the effect of increasing one tax rate on revenues derived from other taxes be considered. For example, increasing cigarette tax rates may have the effect of leaving consumers with less disposable income to spend on commodities which are themselves subject to excise taxes, such as alcoholic beverages.

The rates which would maximize revenues from the tax on cigarettes, alcoholic beverages, and parimutuel wagering are unknown at present, and could only be determined after several years of experimentation with different rates. On the one hand, in the case of commodities such as wine where existing tax rates are very low relative to product prices, it seems

quite likely that tax rates could be increased considerably before revenues would be maximized.

On the other hand, a number of recent studies of the horseracing industry suggest that revenues from parimutuel taxation may not increase significantly, and might even decline, if parimutuel tax rates are significantly increased from their current levels. This is because there appears to be a fairly strong negative relationship between parimutuel taxes and the levels of parimutuel wagering and attendance.

Category 2: Raising a Specific Amount of General Revenue

Under this approach, a tax rate would be established and periodically revised for the purpose of generating a specific amount of revenue. For example, tax rates could be set to fund a projected budgetary shortfall between General Fund expenditures and revenues. Alternatively, rates could be set in order to finance a specific program or activity. Most occupational regulatory programs are financed in this way. The program supported by the tax, however, need not be directly associated with the goods or services being taxed.

Category 3: Intentionally Influencing the Prices Paid for and/or Amounts Consumed of Specific Commodities so as to Compensate for External Effects on Society

Policymakers often use tax policy either to (a) influence the amounts paid for certain commodities, (b) influence the amount of certain commodities consumed by the public, or (c) raise a specific amount of tax revenue on the sale of such items which is equivalent to the costs which the sale or consumption of these items imposes on society but which are not reflected in the market prices of the items themselves.

One common example of where tax policy falls in this category is the taxation of those goods whose production imposes external costs--such as pollution--on society. Instead of prohibiting or directly regulating the production of such goods, policymakers sometimes levy taxes on them that are sufficient to cover the external costs imposed on society. This results in a certain amount of tax collections, and also causes increases in the prices of such products, often bringing about reductions in the amount of these products which people buy. This, in turn, can result in a more efficient allocation and use of scarce resources, while at the same time providing the government with revenues which can be used to offset the costs imposed on society. By relying on tax policy, rather than regulatory policy, to achieve these results, policymakers preserve the freedom of consumers and businesses to make their own decisions regarding how much to consume and produce.

Judging from the popularity of the term "sin taxes," it seems apparent that the consumption of cigarettes, alcoholic beverages, and pari-mutuel wagering are viewed by many persons as being among those activities which can impose costs on society as a whole. This probably explains why special taxes on these activities are considered appropriate.

The criteria to be used in setting tax rates on such items would depend on the Legislature's objectives. One approach would be to simply set target levels of consumption or revenues and then set tax rates so as to achieve these levels. Alternatively, tax rates could be set equal to external costs generated by the use of these commodities, such as certain direct health-related costs in the case of alcohol and cigarette use. Unfortunately, however, it is not possible to accurately measure the direct and

indirect external costs associated with these items. Thus, as a practical matter, tax rates set using this approach would be, at best, only a rough approximation of the full costs incurred by society.

The revenues raised by taxes in this category might be used in a variety of ways. On the one hand, the Legislature might want to maintain a clear link between certain external costs imposed by an activity and the use of the revenues generated by taxing this activity. For example, alcoholic beverage tax revenues could be used to fund programs combatting alcohol abuse, help pay for property damages associated with alcohol-related accidents, and so forth. On the other hand, the Legislature might prefer to place all such revenues in the General Fund and allocate them in the same way as other revenues are allocated. This, in fact, is the approach taken by the Legislature in allocating revenues from the cigarettes, alcoholic beverage, and parimutuel wagering taxes.

Clearly, the tax rates which would compensate for costs imposed on society may be very different from rates that would, for example, maximize revenues. In fact, the rate appropriate for offsetting any particular externality could be either greater or less than the revenue-maximizing rate, depending on the taxed item.

Category 4: Maintaining Parity with Tax Rates in Other States

Under this approach, tax rates for specified commodities would be set so as to equal those in other states.

In general, there is no analytical basis for using this criterion, particularly since there is no reason to expect that the tax policies established by lawmakers in other states would necessarily be appropriate

for California. Nevertheless, the Legislature should be aware of the tax rates set by other states because significant interstate tax rate differentials can produce undesirable economic consequences. For example, there is considerable evidence that significant interstate cigarette tax rate differentials have, in some parts of the country, led to widespread cigarette bootlegging and the counterfeiting of state revenue stamps. This has led some economists to recommend that the federal cigarette tax be increased with the additional revenues redistributed on a formula basis back to individual states. Although the point can vary at which interstate cigarette tax rate differentials make bootlegging and counterfeiting profitable, empirical evidence suggests that a 10 cent per pack tax rate differential between neighboring states is probably sufficient. As seen in Table 1 above, a doubling of California's 10 cent-per-pack cigarette tax would produce a new rate that is 11 cents higher than Oregon's, 10 cents above Nevada's, and 7 cents above Arizona's. These differentials are large enough to raise the possibility that a doubling of the state's current tax rate would result in some undesired economic effects.

In the case of alcoholic beverages, Table 3 shows that California's tax rates on wine and beer are already well <u>below</u> those of its neighbors, so that significant increases in these rates might not produce undesired interstate economic effects. On the other hand, because California's per gallon distilled spirits tax is already close to those imposed by its neighbors, the likelihood that tax rate increases would result in undesired interstate economic effects is somewhat greater.

Horse racing spokesmen have also argued that significant increases in parimutuel wagering taxes could reduce the levels of California's horse

racing wagering and attendance, and thereby reduce the purses available to horsemen, thus inducing the owners of better quality horses to spend less time per year in California and more time at other locations on the national racing circuit. However, the exact interstate tax rate differential at which this problem would arise is not known.

Category 5: Indexing Tax Rates for Inflation in the Prices of Taxed Items

When commodities are subject to excise taxes levied on a cents-per-unit-sold basis, as cigarettes and alcoholic beverages are, the amount of tax revenues collected will rise only with increases in the volume of the commodity sold. Thus, when the prices of such commodities increase due to inflation, the tax collected as a percent of the price which consumers pay continuously declines. This consequence could be avoided if excise tax rates were indexed--that is, if the per unit tax rate increased in line with increases in the price of the taxed item, thereby maintaining the tax as a constant percentage of an item's selling price. The effect of indexing is to make excise taxes which are levied on a physical unit basis similar to selective sales taxes which are levied on the sales price of a commodity.

If the Legislature decided that a constant percentage of both a commodity's per unit selling price and the total amount consumers spend on that commodity should always be used to fund government programs, an indexed tax rate-setting approach would be the appropriate one to follow. As a practical matter, following this approach involves two steps: choosing a price index to use in indexing the tax rate, and selecting the initial tax rate on which future indexing adjustments would "build".

Concerning the choice of price indexes, published components of the Consumer Price Index (CPI) could easily be used to index the excise tax rates for commodities such as cigarettes and alcoholic beverages, although these individual component indexes do have some technical limitations. (Indexing the state's parimutuel wagering tax rate structure would not be necessary since parimutuel taxes are already levied on a percentage rate basis in California.) Regarding the tax rate on which future indexing adjustments would "build", the Legislature would have several choices. For instance, it could use the current tax rate, it could use the current rate adjusted for inflation which has occurred since the rate was adopted, or it could establish some entirely new base rate. The choice of such an indexing base would be a legislative tax policy issue.

Category 6: Indexing Tax Rates for Inflation in Government Costs

Alternatively, tax rates could be indexed to compensate for inflation in the costs of providing government goods and services, instead of inflation in the prices of the taxed commodities themselves. This would be appropriate if the Legislature wished to maintain the purchasing power of the state government's income. This form of indexing would ensure that the taxes collected on the sale of each unit will buy the same "real" amount of government goods and services, in spite of inflation.

In order to implement this form of indexing, excise taxes which are currently levied on a cents-per-unit basis, such as those on cigarettes and alcoholic beverages, would be indexed by the full annual increase in the Implicit Gross National Product Price Deflator for State and Local Government Purchases of Goods and Services, published by the U.S. Department of Commerce.

For the parimutuel wagering tax, which is now levied on a percentage basis, indexing could be applied in one of two ways. On the one hand, the parimutuel tax rate could be indexed for inflation in, say, the state and local government GNP deflator, thereby assuring that each dollar wagered supports the same amount of government services over time. Alternatively, the indexing adjustment could reflect the difference between the rate of government inflation and the rate of inflation in the cost of making a standard bet. This would mean that each standard bet would support a constant level of government services. It should be noted that the prices of standard bets change only infrequently due to the expenses of making modifications to the automatic machinery that handles parimutuel wagering. Therefore, a better method of indexing under this second approach would probably be to simply index parimutuel tax rates by the difference between government cost inflation, and some general measure of price inflation (such as the CPI) which bettors respond to in deciding how much to wager.

Of course, as for the preceding case, in order to apply this criterion the Legislature would also have to determine the tax rate base on which future indexing adjustments are to "build". As discussed earlier, the choice between the above and possibly other taxation objectives and rate-setting criteria is a policy decision which ultimately only the Legislature can make. Naturally, because the tax rates implied by these different objectives and criteria can differ significantly from one another, the revenues as well as the general economic effects they produce can also differ markedly.

CHAPTER III

THE REVENUE IMPLICATIONS OF INCREASING TAX RATES

The revenue implications of increasing the excise tax rates on cigarettes, alcoholic beverages and parimutuel wagering depend primarily on three factors:

- First, the magnitude of such tax rate increases,
- Second, the degree to which these tax rate increases raise the prices at which producers are willing to produce and sell different amounts of the taxed commodity or activity, and
- Third, the extent to which the public reduces its consumption of various taxed items in response to increases in the prices of these items.

An excise tax rate increase will tend to produce a greater increase in revenue, (a) the greater the magnitude of the rate increase itself, (b) the smaller the increase in the product's price, and (c) the smaller the reduction in consumer demand for the product when its price increases (i.e., its "elasticity"). The opposite conditions will produce a weak revenue effect. In fact, it is even possible that an increase in a tax rate will cause a reduction in revenues if it brings about a decline in consumer demand for the taxed product sufficient to outweigh the direct positive impact of the higher tax rate on revenues. In such cases, a decrease in the tax rate would be needed to raise revenues.

Clearly, the most difficult aspect of estimating how changes in tax rates will affect revenues is estimating the probable effects of the change on product prices and consumer demand. The extent to which producers try

to raise product prices when tax rates increase depends on a great many factors which affect business pricing decisions, and it is difficult to separate out the impact of the tax rate change on this decision. For example, because price changes impose administrative costs, producers may not always immediately try to pass the burden of higher taxes on to consumers, particularly if a tax increase is small relative to a firm's production and marketing costs. Thus, at least in the short-run, a business may not take any action in response to a change in the tax rate.

There is even more uncertainty associated with the response of consumer demand to tax-induced price changes. It is commonly assumed, for example, that price elasticity is rather low for items such as cigarettes and alcoholic beverages, causing increases in the tax rates on these items to be fully translated into tax revenue increases. It is quite possible, however, that a large tax-induced increase in cigarette or alcoholic beverage prices would cause a decline in sales of these items. Were this to happen, the revenue increase resulting from an increase in the tax rate would be less than expected on the basis of pre-tax consumption trends.[1] In the case of parimutuel wagering taxation, some studies even suggest that parimutuel tax rate increases could result in outright revenue reductions, because the level of wagering and attendance is relatively sensitive to changes in "price"--that is, the portion of the amount bet that, on the average, is not returned to bettors.

Unfortunately, we do not have sufficient evidence which we can use to confidently predict exactly what consumer response would be to an increase

1. The recent reduction in gasoline demand in response to increased gasoline prices provides a good example of how a product's price elasticity can rise as its price reaches higher and higher levels. Up until fairly recently, many economists believed that the price elasticity of demand for gasoline was quite low.

in cigarette, alcoholic beverage, or parimutuel wagering excise taxes in California, particularly large increases. Given this, our computations of the potential revenue gains from increasing these taxes assume, for illustrative purposes, that the quantities which consumers demand of these items will not fall significantly in response to higher tax rates. Thus, to the extent that consumption does decline, our estimates of the additional revenue resulting from a tax increase are overstated.

To illustrate the potential revenue effect which increases in the excise tax rates on cigarettes, alcoholic beverages, and parimutuel wagering could have, we have analyzed three alternative types of excise tax increases for these items:

- First, an increase of 1 cent in each excise tax rate;[1]
- Second, an increase in each excise tax rate sufficient to make California's rate equivalent to the average rate for all other states; and
- Third, an increase in each excise tax rate sufficient to compensate for the amount of inflation in the price of the taxed item from 1970-71 through 1980-81.

The potential revenue implications of these alternative tax rate changes are discussed below and summarized in Table 4.

Revenue Potential from Increasing the Cigarette Excise Tax Rate

As noted earlier, the Department of Finance projects that California's current 10 cents per pack cigarette excise tax will generate

1. A 1 cent increase in excise tax rates naturally represents very different relative increases in tax rates for these various items, because their existing rates are so different, both in absolute terms and relative to retail prices. For example, a 1 cent increase in the tax on wine is extremely large relative to the existing tax rate, but extremely small relative to the retail cost of wine. On the other hand, a 1 cent increase in the cigarette tax rate is smaller as a percent of the existing tax rate, but larger relative to retail price, than for wine.

approximately $286 million in combined General Fund and special funds revenues during 1981-82. This estimate assumes that taxable distributions of cigarettes will total about 2.9 billion packs in the current year. As Table 1 shows, the average of cigarette excise tax rates in other states is approximately 13 cents per pack. In addition, CPI data from the Bureau of Labor Statistics shows that the CPI for cigarettes rose by about 68.4 percent from 1970-71 through 1980-81.

Based on this information, we find that:

(a) Each 1 cent increase in California's excise tax on cigarettes would yield approximately $28.6 million in excise tax revenues on a full-year basis. (This estimate is based upon existing projections of cigarette consumption.)

(b) In order to bring California's tax rate up to the national average, the rate would have to be increased by 3 cents per pack, which would generate about $85.8 million in excise tax revenues on a full-year basis.

(c) In order to fully compensate for inflation in the price of cigarettes since 1970-71, California's rate would have to be increased by slightly over 6.8 cents per pack. This would produce $195.4 million in additional cigarette tax revenues on a full-year basis.

Of course, the actual amount of revenues raised by any of these tax changes during fiscal year 1981-82 would be less. In projecting the increase in revenues for fiscal year 1982-83, it is important to keep in mind the following:

- There is a one-month lag between when cigarette taxes are levied and when they are transmitted to the state.

- There would be some extra revenues collected if the state also imposed a cigarette "floor tax," so that the new tax rate applied to existing cigarette inventories on which the old rate had already been imposed. Such a floor tax could raise up to $1.2 million in one-time revenues for each 1 cent per pack tax rate increase, assuming that cigarette inventories represent about two weeks' worth of sales.
- There would be some additional state and local sales tax revenues generated by the increase in the excise tax, because the sales tax is imposed on the price of cigarettes including the excise tax.[1]
- Revenues would be less than the estimates given above if increases in the tax rate caused cigarette prices to rise, and thereby reduced consumption.

Revenue Potential from Increasing Alcoholic Beverage Excise Tax Rates

As shown in Table 4, the Department of Finance projects that California's alcoholic beverage excise taxes will generate approximately $147.3 million in 1981-82, including $118.7 million from distilled spirits, $25.1 million from beer, $2.4 million from sparkling wine, $1 million from dry wine, and $160,000 from sweet wine. These estimates are based on the following projections of 1981-82 per capita consumption: 2.44 gallons for distilled spirits; 25.8 gallons for beer; 0.32 gallons for sparkling wine; 4.1 gallons for dry wine; and 0.31 gallons for sweet wine.

1. For example, for a 10 cent excise tax increase resulting in a price increase of 10 cents per pack of cigarettes, state sales tax revenues would increase by .475 cents per pack and local sales tax revenues by .125 cents per pack.

We also know that:

- Inflation rates for alcoholic beverages between 1970-71 and 1980-81, as measured by various components of the CPI, were 74.7 percent for beer, 32.0 percent for whisky, and 83.8 percent for wine; and
- Alcoholic beverage excise tax rates in other states which levy taxes on a cents-per-gallon basis like California average approximately $2.64 per gallon for distilled spirits, 17.2 cents per gallon for beer, 48.6 cents per gallon for dry wine, and 66.8 cents per gallon for sweet wine (see Table 3).[1]

Based on this information, Table 4 shows that, based on existing consumption projections:

(a) Each 1 cent increase in California's alcoholic beverage excise tax rates would yield, on a full-year basis, approximately $8 million in excise tax revenues. This revenue gain is composed of about $593,500 for distilled spirits, $6.3 million for beer, $78,300 for sparkling wine, $1 million for dry wine, and $80,000 for sweet wine.

(b) If California's tax rates were brought up to the national averages for other states which tax alcoholic beverages in a similar fashion, excise tax revenues would increase by $174 million on a full-year basis. This amount is composed of increases of:

- $38.0 million for distilled spirits, reflecting a rise in the tax rate from $2.00 to $2.64 per gallon,
- $83 million for beer, reflecting a rise in the tax rate from 4 cents to 17.2 cents per gallon, and

1. These averages are based only on cents-per-gallon levies and do not include additional taxes in some states, such as levies in the form of price markups charged in state-operated liquor stores.

- $53 million for dry and sweet wines combined, reflecting per gallon tax rate changes of from 1 cent to 48.6 cents for dry wine, and from 2 cents to 66.8 cents for sweet wines.[1]

(c) If California's tax rates were fully adjusted for inflation in alcoholic beverage prices since 1970-71, excise tax revenues would increase by about $60 million on a full-year basis. This amount is composed of increases of:

- $38 million for distilled spirits, reflecting a rise in the tax rate from $2.00 to $2.64 per gallon,
- $18.7 million for beer, reflecting a rise in the tax rate from 4 cents to 7 cents per gallon, and
- $2.9 million for wines, reflecting per gallon tax rate changes of from 1 cent to 1.8 cents for dry wine, from 2 cents to 3.7 cents for sweet wines, and from 30 cents to 55 cents for sparkling wines.

As was noted for cigarette tax rate changes, the actual first year and ongoing revenue increases from raising alcoholic beverage tax rates could differ from the above amounts, depending on such factors as the change in consumption resulting from tax-induced price increases, whether an alcoholic beverage "floor tax" was also levied, and the actual effective date of the tax increase. There would also be additional state and local sales tax revenues generated because the sales tax is imposed on the price of these beverages, including the excise tax.

1. Although the additional revenue from sparkling wines was not computed due to data limitations, this adjustment would add a minimum of $2 million to $3 million to the revenue total, based upon California's current tax rate of 30 cents per gallon.

Revenue Potential from Increasing the Parimutuel Wagering Tax Rate

As Table 4 shows, the Department of Finance projects that in 1981-82, $150 million in state revenues will be generated by parimutuel wagering license fees ($141 million) and breakage ($9 million). These estimates assume that total parimutuel wagering in 1981-82 will exceed $2.5 billion, and that the weighted average tax rate on wagering for all racing meets combined will be approximately 6 percent, although the rates for individual meets will vary considerably. In addition, 1980 data presented earlier indicates that the average wagering tax rate for all other states combined was about 6.5 percent. Based on this information and assuming existing projections of horse racing wagering and attendance, we find that:

(a) Each 1 cent increase in California's tax rate on wagering would yield, on a full-year basis approximately $25 million, and

(b) If California's projected 1981-82 average parimutuel tax rate was raised to the average level in 1980 for all other states which allow wagering on parimutuel horse racing, California revenues would increase by about $12.5 million, again on a full-year basis.

As indicated in Table 4, we have not computed a revenue effect for indexing parimutuel tax rates to inflation in wagering prices, because parimutuel taxation is already levied on a percent-of-dollar-spent basis.

The actual first year revenue increase from any tax rate increases would be particularly sensitive to the timing of the tax increases, because parimutuel wagering occurs unevenly throughout the year, depending on which meets are in operation. By far the most important qualification accompanying these revenue estimates is the assumption that increased parimutuel

tax rates would not reduce the amount of horse racing wagering. As mentioned earlier, a number of recent studies have suggested that horse racing attendance and wagering may be quite sensitive to declining returns to bettors. If valid, these findings would limit the potential revenue gain from an increase in parimutuel tax rates.

Table 4

Effects on Revenues of Selected Tax Increases on
Cigarettes, Alcoholic Beverages, and Parimutuel Wagering
(million of dollars)[a]

Revenue Source	Present Tax Rate	Total General Fund & Special Funds Revenues Projected Under Current Law[b]	Full-Year Effect on 1981-82 Excise Tax Revenues of Alternative Tax Rate Changes						
			A. Increase of 1 Cent in Excise Tax Rates		B. Increase in Tax Rates so that they Equal the Average for Other States		C. Increase in Tax Rates to Compensate for Inflation in Taxed Items Since 1970-71		
			New Tax Rate	Revenue Effect	Average Rate for Other States	Revenue Effect	Inflation Rate[d]	New Tax Rate	Revenue Effect
1. Cigarettes	$ .10 per pack	$285.7	$ .11 per pack	$28.6	$ .13 per pack	$ 85.8	68.4%	$ .168 per pack	$195.4
2. Alcoholic Beverages:									
a. Distilled spirits	2.00 per gallon	118.7	2.01 per gallon	0.6	2.64 per gallon	38.0	32.0	2.64 per gallon	38.0
b. Beer	.04 per gallon	25.1	.05 per gallon	6.3	.172 per gallon	82.8	74.7	.07 per gallon	18.7
c. Wine:									
- Dry wine	.01 per gallon	1.0	.02 per gallon	1.0	.486 per gallon	47.6	83.4	.018 per gallon	0.8
- Sweet wine	.02 per gallon	0.2	.03 per gallon	0.1	.668 per gallon	5.2	83.4	.037 per gallon	0.1
- Sparkling wine	.30 per gallon	2.4	.31 per gallon	0.1	(e)	(e)	83.4	.55 per gallon	2.0
Subtotal, Alcoholic Beverages		$147.3		$ 8.0		$173.6			$59.6
3. Parimutuel Wagering	$ .06 per dollar wagered[f]	$150.0[g]	$ .07 per dollar wagered	$25.0	$ .065 per dollar wagered[h]	$ 12.5	(i)	(i)	(i)
Totals, Cigarettes, Alcoholic Beverages, and Parimutuel Wagering		$583.0		$61.6		$271.9			$255.0

a. Data may not add to totals due to rounding. All figures rounded to nearest $100,000. Estimates assume that consumer demand for taxed items will not decline in response to higher tax rates, and exclude the additional state and local revenues from levying the sales tax on the increased excise taxes. The sales rate is 4.75 percent for the state and, in general, 1.25 percent for local governments.
b. Department of Finance estimates, May 1981.
c. Average tax rates do not include, in the case of alcoholic beverages, certain types of taxes such as price markups in state-operated liquor stores which may be in addition to statutory cents-per-gallon levies in some states.
d. Inflation rates based upon published data for CPI components, U.S. Bureau of Labor Statistics (BLS). Inflation for distilled spirits is measured by inflation for whisky. There is only one inflation rate published by the BLS for wines, representing a weighted average of different types of wines.
e. Not computed due to data limitations. However, since California's per gallon tax on sparkling wine is 30 cents per gallon, and dry and sweet wines are taxed on the average at close to twice this rate in other states, the additional revenues from raising the tax rate would probably be a minimum of $2 million to $3 million.
f. Computed as the sum of parimutuel license fees and breakage, as a percent of dollars wagered.
g. Parimutuel license fees plus breakage, but excluding approximately $5 million in other horse racing-related revenues such as unclaimed parimutuel tickets, fines, etc.
h. Based on 1980 parimutuel wagering data as published by the National Association of Racing Commissioners. Data includes off-track betting activity in Connecticut and New York.
i. Not computed since California parimutuel wagering is already taxed on a percent-of-dollar-spent basis.

APPENDIX A

INTERSTATE COMPARISON OF PARIMUTUEL TAXATION IN 1980[a]

Arizona
Total take-out 18%. State receives 3% of first $100,000 and 5% all over $100,000 daily average; 1% to state from tracks who do not exceed $200,000. Breakage 10 cents, 50% to track, 25% Arizona Bred Purse Structure. FAIRS: County in which fair is located receives pari-mutuel tax revenue, instead of state. Net under pay to state at end of meet.

Arkansas
Total take-out 16%. Pari-mutuel tax to state 6%, $500 daily license fee, 10 cents on paid admissions. Breakage 10 cents, divided ⅓ to association, ⅔ to city where track is located with a portion going to the county.

California
Total take-out 15.75% for thoroughbred and quarter horse meetings, 16.75% for harness and fair race meetings; optional increase of up to 3% for exotic wagering pools (daily doubles, exacta five tax schedules: 1. Thoroughbred meetings with average daily handle exceeding $650,000 (sliding scale of 6.10% to 7.45% to state, 5.29% to 4.5% to track, balance to purses and breeders funds); 2. Quarter horse and harness with average daily handle exceeding $650,000 (same as schedule 1, but no distribution to breeder funds); 3. Fair meetings with average daily handle exceeding $650,000 (5.5% to state, 5.35% to purses, 4.9% to track); 4. Meetings averaging $650,000 or less (sliding scale to state 2.5% to $29,000 plus 7.5% over $600,000, remainder distributed 50-50 to track and purses except for quarter horse which is negotiable); 5. Fair meetings averaging $650,000 or less (sliding scale to state of flat 1% to $9,250 plus 4% of amount over $550,000). Breakage at harness to purses and sire and sire stakes program, breakage at all other meetings distributed between tracks and purses on first $24 million, 100% to purses from $24 to $50 million, 100% to state over $50 million.

Colorado
Total take-out 17%. State tax revenue is paid at a rate of 3½% of the gross mutuel handle. Breakage 10 cents, all to association.

Delaware
THOROUGHBRED: Total take-out 17% plus 2% on daily doubles and exactas, plus 8% on exotic wagers. Daily license fee $10,000. Additional tax to state on a graduated basis from 20% to 90% of the track's average daily income in excess of $145,000. Breakage 10 cents, all to association. Uncashed pari-mutuel tickets revert to state after one year. HARNESS: Total take-out 18% on straight bets, 20% on multiple bets on 8-horse field, 25% on multiple bets on 9-horse field. State receives .75% of the first $400,000; 3% of $400,000 to $600,000; 5.5% of all over $600,000. Delaware Standardbred Development Fund receives ½ of 1% from tracks handling more than $300,000 per day. Breakage to 10 cents reverts to track. Uncashed pari-mutuel tickets revert to state after one year.

Florida
1-1-80 thru 6-3-80: THOROUGHBRED: Total take-out 17.6%. Breakage 10 cents. 5 cents on minus pools. SOUTH FLORIDA WINTER: State receives 5.6% to 6.2% minus $1,800 allowance per race for overnight purses. 100% breaks to state. Purses 5%. FLORIDA DOWNS: State receives .6% and fixed daily license fee from $4,000 to $11,000 with $400 per race allowance. 100% breaks for breeders awards and purses. SUMMER: State receives 5.6% minus $2,100 per race allowance. 100% breaks for breeders awards. HARNESS: Total take-out permitted 19%. State receives 5.3% minus $450 per race allowance not to exceed $450,000. Breakage 10 cents divided between state and promotional trust fund. QUARTER HORSE: Total take-out 18%. State receives sliding scale fees from $1,000 to $6,000 per day plus 1% for promotional trust fund. Breakage 10 cents divided between state and promotional trust fund. ALL: Admissions 15% of entrance gate admission or 10 cents per person whichever is greater. 6-4-80: Total take-out permitted: 17.6% on regular wagering (win/place/show); 19% on exotic wagering (wagers involving two or more animals in a single wager); an additional ½% on regular wagering and an additional 1% on exotic wagering may be taken out for capital improvement fund. Tax on handle: 3.3% of handle in excess of $300,000 each performance, except as follows: SECOND PERIOD/WINTER THOROUGHBRED: 3.3% of handle in excess of $175,000 per performance, and tracks with under $400,000 average daily handle in preceding season: 3.3% of handle in excess of $500,000 per performance. (An additional 1% of handle is collected on Quarter Horse solely for the Florida Quarter Horse Racing Promotional Trust Fund). Daily license fee of $100 per race if average daily handle was greater than $100,000 per performance for preceding season; $50 per race if average daily handle was less than $100,000 per performance for preceding season. Breakage 10 cents, 100% for Florida Thoroughbred Breeders Promotional Trust Fund, Florida Harness Horse Racing Promotional Trust Fund, Florida Quarter Horse Racing Promotional Trust Fund. Admissions 15% of entrance gate admission or 10 cents per person, whichever is greater. Purses: The minimum purse provision is the minimum about that a horse racing permitholder must contribute from commission for purses: Thoroughbred 7.5%; Harness 7.5% of handle; Quarter Horse 6% of handle.

Idaho
Total take-out 20%. Racing Commission receives 1¼%; ½% to Owners and Breeders Awards; ½% to small track purses. Public schools receives ¼% to 2¼% based on a sliding scale. Balance to associations. Association accrues all monies in unclaimed tickets at termination of time allowed by rule of the commission. Daily license fee $25, fairs exempt.

Illinois
Total take-out: Win, place, show wagering 17%; Daily Double, Quinella, Perfecta wagering 20.5%; Trifecta wagering 25%. State receives on a sliding scale of daily pari-mutuel handle 1.75% up to and including the first $200,000 to 7.75% over $3,000,000. Breakage 100% to state for regular meet; 50% to state for charity meets.

KENTUCKY
THOROUGHBRED: 1/1/80 to 7/15/80: Total take-out 15%. 7/15/80: Total take-out to tracks over $900,000 daily average, 16% on straight betting and 19% on Daily Double, Exacta, Quienella; Take-out to tracks under $900,000, 17½% on straight betting and 19% on Daily Double, Exacta, Quienella, ½ to 1% to Backside Improvement Fund. State receives 4¾%. From state share Ky. Thoroughbred Development Fund receives .25% Jan. thru June and .50% July thru Dec. Daily license $500 if average daily handle at track during year does not exceed $450,000; $1,000 at tracks with average daily handle $450,000 to $600,000; $2,500 at tracks where sum exceeds $600,000. Breakage 10 cents, all to association. Unclaimed pari-mutuel tickets revert to Ky. Racing Health and Welfare Fund after two years. HARNESS: Total take-out 18%. State receives 4%, Standardbred Development Fund 1%. Daily track license $100. Breakage 10 cents, all to association. Unclaimed pari-mutuel tickets revert to state after two years.

Louisiana
Total take-out 17%, 20% exotic pools. State receives: On total daily pool up to $201,000, 4% exceeding $60,000; $201,000 to $401,000, $5,640 plus 5% exceeding $201,000 up to $401,000; $401,000 and over, $15,640 plus 6% exceeding $401,000. When two or more conflicting race meetings occur within the state, state receives: On Total daily pool up to $201,000, 4% exceeding $100,000; $201,000 to $401,000, $4,040 plus 5% exceeding $201,000 up to $401,000; $401,000 and over, $14,040 plus 6% exceeding $401,000. Minimum daily license fee $1,000 thoroughbreds; $500 quarterhorse. Admission 10 cents. Breakage 10 cents, ½ to association, ½ to Louisiana Breeders Funds to supplement purses.

Maine
Total take-out on straight betting 16%; .87% to State Commission, 1.13% Agricultural Stipend, 1% to Purse Supplement, 13% to Association. Total take-out on exotic betting 25%; 5.37% to State Commission, 1.13% Agricultural Stipend, 1½% Sire Stake Fund, 2½% Purse Supplement, 14½% to Association. All breaks and outs tickets retained by the Association.

Maryland
THOROUGHBRED: Total take-out 15% on straight bets, 19% on two-horse pools, 25% on more than two. State receives 4.09%, Maryland Bred Fund 1%, other funds, 75%. Breakage 10 cents, 50% to tracks, 45% to purses, 5% to Maryland Bred Fund. HARNESS: Take-out 17% on straight bets, 19% on two-horse bets, 25% on more than two. State receives 3.5% of the first $125,000, 6% in excess of $125,000. At tracks handling less than $125,000 daily, state receives 3%.

Massachusetts
THOROUGHBRED (MAJOR TRACKS ONLY): Total take-out 19%; 5% to state, 7% to association, 7% to horsemen. License fee $100 per day. THOROUGHBRED RACING AT FAIRS: Total take-out 19%. State receives 4% to $100,000; 9%, $100,000 to $300,000; 10% to $300,000 to $500,000 and over. License fee $50 per day. HARNESS (MAJOR TRACKS AND FAIRS): Total take-out 19%; 3% to state, 8% to association, 8% to horsemen. License fee major tracks $200 per day, fairs $50 per day. All breakage from Suffolk Downs and New England Harness Raceway goes into the Improvement Trust Fund.

Michigan
Total take-out 16½% on straight betting, 20% on doubles and other multiples. Breakage 10 cents, ½ to state and ½ to association. THOROUGHBRED: State receives 5½% on straight bets and doubles, 10% on other multiples. HARNESS AND QUARTER HORSE: State receives 5½% across the board. APPALOOSA: State receives 5½% on straight and double betting, 5% of other multiples.

Montana
Total take-out 20% plus breakage. The licensee shall pay to the Board of Horse Racing 1% of all gross receipts on each days pari-mutuel betting at each race meet, which sum shall be paid to Board within five days after the end of race meet. If underpayments exceed overpayments at the end of each race meet, the balance shall be paid to the Board. Breakage 10 cents, all to licensee. All unclaimed winning tickets 30 days after the end of a race meet are paid to the Board. (No tax paid to State of Montana.)

Nebraska
Total take-out 15%. No tax first million; thereafter, state receives 5%. Tax on admissions 30 cents which, along with monies received in license fees, is distributed among counties of state for county fair premiums. Breakage 10 cents, all to association.

Nevada
Total take-out 18% with 2% to state and 1% to racing commission for administrative work. Any amount over $10,000 is to be distributed to agricultural districts conducting horse racing proportionately to the amount contributed by each district. Breakage 10 cents, all to association.

New Hampshire
THOROUGHBRED: Total take-out 18% — Win-Place-Show. State receives 5%; Association 10%. Total take-out 25% Multiple Wagering. State receives 10%; Association 15%. No license fee, but bond not exceeding $300,000 required. Breakage 10 cents, divided equally between State and Association. HARNESS: Total take-out 19% — Win-Place-Show and 25% Multiple Wagering. Divided as follows: Of Total Pari-Mutuel Sales for any one day. State receives on first $100,000 of sales — 1% of Win-Place-Show and 2% of Multiple Wagering. Next $150,000 — 4% of Win-Place-Show and 8% of Multiple Wagering. $250,000 and over 5½% of Win-Place-Show and 8% of Multiple Wagering. Track licenses paid to township where track is located. Breakage 10 cents, divided equally between State and Association.

New Jersey
THOROUGHBRED: Total take-out 17% on straight betting, 19% on two-horse selections, 25% on three-horse selections. State's share of take-out at private tracks averaging less than $1,000,000 in total mutuel handle. .42% of 1.42%, private tracks averaging more than $1,000,000 in total mutuel handle 3.42% to 4.42%, at Sports Complex .5%; tracks share of take-out at private tracks averaging less than $1,000,000 in total mutuel handle 8.57% to 12.12%, tracks share of take-out at private tracks averaging more than $1,000,000 in total mutuel handle 6.81% to 10.29%, at Sports Complex 12.11% to 16.61%; remainder to purses and breeders program. Breakage 10 cents, at private tracks reverts to state, at Sports Complex reverts to track. HARNESS: Total take-out same as thoroughbred; State share of take-out at private tracks 2.30% to 7.30%, at Sports Complex .5%; track share of take-out at private tracks 6.00% to 9.00%, at Sports Complex 10.50% to 16.50%; remainder to purses and sire program; Breakage 10 cents, at private tracks reverts to state, at Sports Complex reverts to track.

New Mexico
Total take-out 18%. State receives 2% to $250,000; 3½% over $250,000 to $350,000; 4½% over $350,000 to $400,000; 7% over $400,000; except State Fair which pays a maximum 2% on total handle. Tax on admissions, 10 cents. Daily license fee $300, half to state and half to county in which track is located, except State Fair charge $10 per race day. Breakage 10 cents, all to association. New Mexico Breeders Award ½%; tracks for Capital Improvements ¼%.

New York
THOROUGHBRED: Total take-out on regular betting at the New York Racing Association Tracks (Aqueduct, Belmont and Saratoga) is 14% from 1/1/80 - 5/31/80. Total take-out from 6/1/80 on is 17% on regular betting. On exotic betting (3 or more horses) total take-out 25%. The State receives 2% on regular through 5/31/80. From 6/1/80 on, the State receives 5%. On exotic betting, the State receives 7½%. At Finger Lakes, total take-out was 17% on regular and 25% on exotic. The State receives 3.6% regular and 8.85% of exotic. The Breeder's Fund receives 0.40% of all pools at all Thoroughbred Tracks. Breakage 10 cents on regular and 50 cents on exotic with State receiving 20% at the New York Racing Association Tracks and 55% at Finger Lakes. State receives a minimum of $30,000 per racing day as franchise fee from Aqueduct, Belmont and Saratoga, and $100 per day license fee from Finger Lakes. HARNESS: Total take-out on regular betting is 17%. On multiple betting (i.e. on 2 horses: Daily Double, Exacta, Quinella) total take-out is 19%; on exotic betting (3 or more horses) total take-out is 25%. At Roosevelt and Yonkers, State receives 6½% on regular betting, 7½% on multiple and 11½% on exotic if 10 races or more are held. For programs at which less than 10 races are held, State receives 7½% on regular, 8½% on multiple and 12½% on exotic. At all other Harness Tracks, State receives 3% regular, 3½% on multiple, and 8% on exotic through 11/30/80. From 12/1/80, the State receives 2% regular, 2½% on multiple, and 7% on exotic. Breeder's Fund receives ½% on all betting pools. At all harness tracks, breakage 10 cents on regular and multiple, and 50 cents on exotic, with State and association each receiving 50%. State receives a license fee of $100 per day.

Ohio
Total take-out 17% THOROUGHBRED: State receives 6½%, of which .5% goes to Ohio Fairs Fund and .5% to Ohio Thoroughbred Race Fund; purses 5½%. HARNESS: State's share on sliding scale from 3% of first $50,000 to 6½% of all over $550,000, Ohio Standardbred Development Funds receives .5%. QUARTER HORSE: State's share on a sliding scale from 0% of first $50,000, 2% of next $50,000 4% of next $100,000, 6% of next $350,000 and 6½% of all over $550,000; .5% to Ohio Quarter Horse Development Fund. Breakage 10 cents, of which state receives 25% of all in excess of $2,000 in a calendar year. 40% of association's share of breakage to Ohio-bred races and other purses. Taxes of associations that make capital improvements are reduced by .5%.

Oregon
Total take-out 16%. State receives 4% from commercial race meets and 1.2% from non-profit race meets (includes fairs) 0.9% where the daily average pari-mutuel handle is over $150,000 during preceding year. Daily license for commercial race meets $100. Non-profit (includes fairs) meets $25. per race meet. State receives unclaimed winning tickets 90 days after meet ends and all underpays. Breakage 10 cents — Track retains 45% and 55% to be used for breeder's awards, stallion awards, horsemen education and promotion and development of horse breeding and racing. The following applies only to race meets where the average daily gross mutuel wagering during the preceding year exceeded $150,000; 1% of the gross mutuel wagering is apportioned among the owners of Oregon-bred horses as purse supplements in the same ratio that each owner's purses bears to the total purses won by Oregon-bred horses at the race meet. 5.4% of mutuel handle is paid for purses. 0.2% is earmarked for backside improvements.

Pennsylvania
THOROUGHBRED: Total take-out 17%-19%. Penn National and Keystone (average daily handle is greater than $300,000) take-out is 17% on straight wagering; 19% on exactas, quinellas, and doubles; 25% on trifectas. Commodore Downs and Pocono Downs (average daily handle is less than $300,000) take-out is 19% on all wagering; 25% on trifectas. State receives 4.75% track 11.75% - 13.75%, breeders fund 0.5%. Breakage 10 cents, 5 cents on minus pools, divided equally by state and track. Track license, $1,000 per association track retains balance. HARNESS: In first-class school district, take-out 17% on straight wagering, 19% on multiple, 25% on exotic. State receives 1% school district 4%, Sire Stakes Fund .05%, track retains balance. Distribution in other than first-class districts; take-out 17% on straight wagering, 19% on multiple and exotic. State receives 3%, Department of Commerce 1.99%, Sire Stakes Fund .05%, track retains balance. When handle is less than $300,000, take-out 19% on straight and multiple wagering, 25% on exotic. State receives 3%, Department of Commerce 1.99%, Sire Stakes Fund .05%, track retains balance. Breakage 10 cents, shared equally by state and track. State money from breakage designated to Sire Stakes Funds. In a minus pool, track must distribute 5 cents on each dollar wagered.

South Dakota
Total take-out 18¼%. Of first $2,000,000, state 4%; track 14¼% $2,000,000 and over, state 4%; track 13%; county 1¼%. On daily handles under $100,000, state 3%; track 15¼% of first $2,000,000. $2,000,000 and over, state 3%; track 14%; county 1¼%. 4/17 of all contributions to state, ¼ to Breeder Racing Fund, remainder to Special Racing Fund. Breakage 10 cents, to association.

Vermont
HARNESS: Commissions on the harness racing pools shall not exceed 19% of each dollar wagered except commissions on the harness racing pools from racing conducted on Sundays shall not exceed 20% of each dollar wagered and commissions on each harness racing trifecta pool shall not exceed 25 percent. From harness racing, on the total wagered each race day conducted Monday through Saturday; 3% on the first $150,000.00, plus 4% on the amount $150,000.00 - $200,000.00 plus 5% on the amount $200,000.00 - $250,000.00 plus 6% on the amount $250,000.00 - $300,000.00 plus 7% on the amount $300,000.00 - $350,000.00 plus 8% on all over $350,000.00. From harness racing, on the total wagered each race day conducted on Sunday: 4% on the first $150,000.00 plus 5% on the amount $150,000.00 - $200,000.00 plus 6% on the amount $200,000.00 - $250,000.00 plus 7% on the amount $250,00.00 - $300,000.00 plus 8% on the amount over $300,000.00. All breakage shall be paid to the licensee.

Washington
MAJOR TRACKS: Total take-out 16%. State receives 4% from daily handle less than $500,000. For handle in excess of $500,000, state receives 4½% of the first $500,000, plus 5% of handle above $500,000. MINOR TRACKS: Take-out 15%, with 1% to state. Breakage 5 cents, all to association.

West Virginia
Total take-out 17.25% on straight bets, 25% on multiples. March thru October: State receives 5.75%, horsemen's purses 5.75%, association 5.65%, county .10%. On multiples state receives 5.75%, horsemen's purses 9.75%, association 9.40%, county .10%. November thru February: On straight bets state receives 5.25%, horsemen's purses 6.75%, association 5.15%, county .10%. On multiples state receives 5.25%, horsemen's purses 10.75%, association 8.90%, county .10%. State receives unclaimed winning ticket money to pay breeder's awards and supplement certain stake races. Breakage 10 cents, all to association.

Wyoming
Total take-out 20%, with 1% to Pari-Mutuel Board for operating expenses, (none to state or city), 19% to racing association. Breakage 10 cents, all to association.